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# United States Senate

COMMITTEE ON FINANCE  
WASHINGTON, DC 20510-6200

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October 11, 2016

The Honorable Jacob Lew  
Secretary  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Dear Secretary Lew:

Earlier this year, I wrote to you on two occasions regarding my concerns with the Treasury Department's processes for issuing tax regulations. On April 28, I wrote asking that the Treasury Department release its long-secret Memorandum of Agreement (MOA) with the Office of Management and Budget (OMB) concerning the economic and regulatory effects of tax regulations.<sup>1</sup> For decades, the MOA has led to reduced transparency and allowed the Treasury Department to circumvent the accountability requirements imposed by both executive orders and numerous federal statutes. On August 22, I wrote asking that the Treasury Department withdraw and repropose its proposed debt-equity regulations under Internal Revenue Code section 385 (the "proposed regulation") which would hamper job growth and reduce the country's economic competitiveness abroad. Today, I write to 1) set forth the details of that MOA and request information on its use, and 2) raise additional questions concerning the proposed regulation and the Treasury Department's unusual process in moving toward a final rule.

These issues matter a great deal to me because federal regulations have grown in quantity and scope to unprecedented levels in recent decades, and tax regulations are no exception. Over the years, both Congress and the President have sought to ensure transparency in the issuance of regulations. Among the statutory directives governing regulatory transparency are the Administrative Procedure Act [requiring public notice and opportunity for comment],<sup>2</sup> the Regulatory Flexibility Act [requiring agencies to account for a regulation's impact on small entities],<sup>3</sup> and the Congressional Review Act (CRA) [requiring that the agency provide to Congress "a complete copy of the cost-benefit analysis of the rule, if any...."]<sup>4</sup>

Cost-benefit analysis is typically conducted pursuant to executive order, as initially required by President Reagan's E.O. 12291 and now President Clinton's E.O. 12866. The executive orders generally require federal departments to determine whether a new regulation has an annual effect on the economy of \$100 million or more, or has other significant effects. If the regulation has

<sup>1</sup> I also wrote you in 2013 and in 2014 asking for a copy of the MOA.

<sup>2</sup> 5 U.S.C. § 553

<sup>3</sup> 5 U.S.C. § 603

<sup>4</sup> 5 U.S.C. § 801

any of the listed significant effects, it is deemed a “significant regulatory action” under E.O. 12866. This determination matters because it triggers an assessment of the need for the regulation by OMB, a public accounting of the costs and benefits of the regulation, and further analysis and procedural protections under the CRA. These requirements do not fix the problem of overregulation, but they allow for a degree of transparency regarding the economic burdens associated with regulatory action.

Unfortunately, these transparency and accountability requirements appear to have been thwarted for decades due to the Treasury Department’s long-secret MOA with OMB’s Office of Information and Regulatory Affairs (OIRA). They have also appeared to have been thwarted due to the Treasury Department’s long-held view that Treasury regulations are “interpretive” (meaning they merely interpret the language of the Internal Revenue Code (IRC) and thus do not by themselves give rise to regulatory costs) rather than “legislative” (meaning they are authorized under the IRC and create operational rules, thus creating their own regulatory costs). After I requested that the Treasury Department release the MOA in April (which followed similar requests in 2013 and 2014), Committee staff independently obtained a copy of the document, and the Treasury Department later agreed to its release. I have attached it to this letter.

The MOA consists of the original 1983 memorandum and a subsequent 1993 ratification of its substance in light of E.O. 12866. The 1983 memorandum states that the “review procedures of the Executive order are waived with respect to all regulations except legislative regulations that are ‘major’....” The MOA makes the Treasury Department responsible for alerting OMB to any “major” regulation for which executive order requirements are waived, as well as non-major ones that may have a significant economic impact. Importantly, the MOA also notes that prior to publication of any regulation, the Treasury Department must provide OMB with a statement explaining the basis for “determining that the regulation is not a major regulation or, in the case of an interpretive regulation, explains why the regulation is considered interpretive.” The 1993 MOA, in the form of a December 22, 1993 letter from the Administrator of OIRA to the General Counsel of the Treasury Department, ratifies that the same rules apply under E.O. 12866

Due to the Treasury Department’s view that nearly all of its tax regulations are “interpretive,” this agreement essentially eviscerates the criteria of both the executive orders and the CRA. In fact, the Government Accountability Office recently found that only two tax regulations were deemed economically significant in recent history: the 2011 regulation governing paid tax-return preparers which was later overturned by the federal courts, and the April 2016 proposed regulation under IRC § 385.<sup>5</sup> In the case of the 2011 regulation, Treasury originally deemed the proposal not economically significant and was reversed by OMB.<sup>6</sup> In the case of the 2016 proposed regulation, the Unified Agenda originally listed the proposed regulation as

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<sup>5</sup> U.S. Government Accountability Office, *Regulatory Guidance Processes: Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance*. GAO-16-720, at 18-19 (Sept. 2016) <http://www.gao.gov/assets/680/679518.pdf>

<sup>6</sup> U.S. Government Accountability Office, *Regulatory Guidance Processes: Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance*. GAO-16-720, at 20-21 (Sept. 2016) <http://www.gao.gov/assets/680/679518.pdf>

“economically significant,”<sup>7</sup> but that determination was apparently changed according to the information posted on [www.reginfo.gov](http://www.reginfo.gov) when OMB received the rule for review – a determination that was subsequently changed *back* to “economically significant” by October 4.<sup>8</sup>

Further demonstrating the Treasury Department’s questionable views on the economic significance of regulations, the same GAO report found 15 examples – between 2013 and 2015 alone - where the Treasury Department issued joint regulations with other agencies in which the other agency deemed significant or economically significant, though Treasury did not.<sup>9</sup> The Treasury Department’s compliance with regulatory processes is not limited to questions of “economic significance.” The GAO also recently found that “Treasury... rarely perform(s) a regulatory flexibility analysis assessing a regulation’s impact on small businesses and other small entities as generally required by the Regulatory Flexibility Act.” Of over 200 tax regulations issued from 2013 to 2015, only two included a regulatory flexibility analysis. This is due – again – to the Treasury Department’s view that any economic impact flows not from the “interpretive” tax regulation but from the underlying statute.

Across the wide breadth of tax regulations issued in recent years, in almost every instance, the Treasury Department makes choices that shield tax regulations from transparency, cost-benefit analysis, and other oversight requirements provided under Executive Orders and federal law. I will continue to work to reverse this trend and provide greater transparency and accountability to tax regulations. Toward that end, I ask that you provide the following information related to Treasury’s use of the MOA and recent regulatory actions by no later than December 2, 2016, and before any final regulations are promulgated under section 385:

1. As described above, the Treasury Department’s proposed debt-equity regulations under Internal Revenue Code section 385 was listed as not economically significant on September 30, before going back to its original designation as economically significant by October 4. Since the proposal is currently undergoing E.O. 12866 review at OMB, which determination has the Treasury Department made?
2. According to the text of the 1983 MOA, “prior to publication of a regulation in the Federal Register, and at such times as Treasury may determine, Treasury will provide to the appropriate OMB desk officer three (3) copies of a statement that:... indicates the basis for determining that the regulation is not a major regulation or, in the case of an interpretive regulation, explains why the regulation is considered interpretive.”
  - a. Does the Treasury Department comply with this provision of the MOA?
  - b. In the past two years, how many statements have been provided to OMB under this provision?

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<sup>7</sup> <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201604&RIN=1545-BN40>

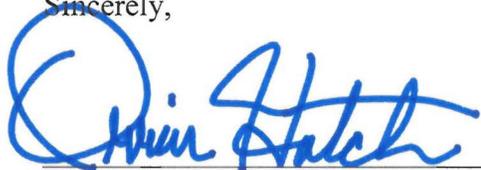
<sup>8</sup> <http://www.reginfo.gov/public/do/eoDetails?rrid=126804>

<sup>9</sup> U.S. Government Accountability Office, *Regulatory Guidance Processes: Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance*. GAO-16-720, at 20 (Sept. 2016) <http://www.gao.gov/assets/680/679518.pdf>

- c. Provide the statement or statements, if any, transmitted to OMB with the Treasury Department's proposed or final debt-equity regulations under Internal Revenue Code section 385.
3. Seeking to improve the regulatory process, President Obama issued E.O. 13563, which requires, among other things, that within "120 days of the date of this order, each agency shall develop... a preliminary plan... under which the agency will periodically review its existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded, or repealed so as to make the agency's regulatory program more effective or less burdensome in achieving the regulatory objectives."
  - a. Did the Treasury Department develop this plan? If so, please provide it.
  - b. Identify any tax regulation that has been "periodically review[ed]" and whether it was determined if it could be "modified, streamlined, expanded, or repealed."
4. In the report discussed above, the GAO recommended that the Treasury Department examine the relevance of the MOA. The Treasury Department's response to the GAO recommendations stated that "no change in circumstances has occurred that would warrant changes or a reaffirmation" of the MOA. Please explain the MOA's original purpose, and how the MOA continues to serve taxpayers, regulatory accountability, or transparency.
5. Does the Treasury Department or OMB designate regulations as "major" within the meaning of the Congressional Review Act?
6. Does the Treasury Department view the proposed regulations as interpretive or legislative? Does the Department take the position that there could be multiple permissible interpretations of section 385 within Treasury regulations?

Thank you for your continued assistance in this important matter.

Sincerely,



Orrin G. Hatch  
Chairman